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In Re:

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CC:CORP:B05 – PLR-147055-03

Date:

December 04, 2003

LEGEND:

Distributing =

Controlled =

Sub 1 =

Sub 2 =

LLC 1 =

LLC 2 =

Corp 1 =

State X =

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r dollars =q dollars =v =w percent =x percent =y percent =z percent =zz percent =Business a =Business b =Business c =A =B =

Date 1 =

R =

S =

Dear :

This letter responds to your August 8, 2003, request for rulings on certain federal income tax consequences of a proposed transaction. The facts submitted for consideration are substantially as set forth below.

Distributing is a State X corporation which operates as a holding company. Distributing has outstanding a single class of voting common stock, x percent of which is held by LLC 1. The remaining shares are held by others, none of whom own five percent or more thereof.

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Distributing wholly owns Sub 1 and Sub 2, both of which are State X corporations. Sub 1 is engaged in Business a and Sub 2 is engaged in Business b. Sub 1 has outstanding solely voting common stock.

LLC 2 is a State X limited liability company which is engaged in Business c. Distributing holds a w membership interest in LLC 2. The remaining y membership interest in LLC 2 is held by Corp 1.

Corp 1 is a State X corporation which has outstanding a single class of common stock, 50 percent of which is held by each of individuals A and B.

Financial information has been submitted which indicates that each of Business a and Business b has had gross receipts and operating expenses representative of the active conduct of a trade or business for each of the past five years.

A is key employee of Sub 1. A has expressed a desire to acquire a significant equity interest in a corporation that reflects the value of Sub 1's business. At the same time A does not want to be subject to a majority corporate shareholder that might allocate Business a's resources to a sister operating entity (Sub 2).

Accordingly, the following transaction is proposed:

- (i) Sub 1 will cancel intercompany debt in the amount of \$r dollars that Distributing owes Sub 1.
- (ii) Distributing will form Controlled as a State X corporation with only voting common stock authorized and outstanding.
- (iii) Distributing will transfer all of the stock of Sub 1 and its interest in LLC 2 to Controlled in exchange for all of the outstanding stock of Controlled and the assumption by Controlled of certain liabilities of Distributing.
- (iv) Controlled will contribute to Sub 1 the interest in LLC 2 it receives from Distributing in constructive exchange for Sub 1 stock.
- (v) Sub 1 will acquire the remaining interest in LLC 2 from Corp 1, in exchange for Sub 1 voting common stock, which will amount to between z and zz percent.
- (vi) Distributing will distribute, on Date 1, all of Controlled's stock to its shareholders on a pro rata basis.

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The Sub 1 voting common stock issued to Corp 1 in step (v), above, will be identical in all respects to the Sub 1 voting common stock theretofore outstanding except that it will be redeemable by Sub 1 under certain limited circumstances. In addition, Corp 1 will have a right to require Sub 1 to redeem the Sub 1 shares it holds which, if fully exercised, would leave Corp 1 with no less than y percent of the outstanding stock of Sub 1 as of December 31, 2008. If fully exercised, however, at least g dollars of the investment by Corp 1 in the Sub 1 stock would remain at risk in Sub 1.

Following the distribution Distributing and Controlled will share R directors which will constitute a minority of each board. Distributing and Controlled will also have the same chief financial officer and will share S employees who perform secretarial, accounting, and technical support functions.

In connection with the proposed transaction, it has been represented that:

- (a) No part of the Controlled stock being distributed by Distributing will be received by a shareholder as a creditor, employee, or in any capacity other than that of a Distributing shareholder.
- (b) The 5 years of financial information submitted on behalf of Sub 1 and Sub 2, in each case, represents its present operation, and, there have been no substantial operational changes since the date of the last financial statements submitted.
- (c) Following the distribution, Sub 1 and Sub 2 will each continue the active conduct of its business, independently and with its own employees (with the exception of the board the directors, the chief financial officer and the S employees, as described above.)
- (d) Immediately after the distribution, at least 90 percent of the fair market value of the gross assets of Distributing will consist of the stock of Sub 2, a controlled corporation that is engaged in the active conduct of a trade or business as defined in § 355(b)(2).
- (e) Immediately after the distribution, at least 90 percent of the fair market value of the gross assets of Controlled will consist of the stock of Sub 1, a controlled corporation that is engaged in the active conduct of a trade or business as defined in § 355(b)(2).

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- (f) The distribution of all the stock of Controlled is carried out for the following corporate business purpose: to provide a meaningful equity stake to the key employee of Sub 1. The distribution of all the stock of Controlled is motivated, in whole or substantial part, by this corporate business purpose.
- (g) There is no plan or intention by the shareholders of Distributing to sell, exchange, transfer by gift, or otherwise dispose of any stock in Distributing or Controlled after the distribution.
- (h) There is no plan or intention by either Distributing or Controlled, directly or through any subsidiary corporation, to purchase any of its outstanding stock after the distribution, other than through purchases meeting the requirements of § 4.05(1)(b) of Rev. Proc. 96-30.
- (i) There is no plan or intention to liquidate either Distributing or Controlled, to merge either corporation with any other corporation, or to sell or otherwise dispose of the assets of either corporation after the distribution, except in the ordinary course of business.
- (j) The total adjusted bases and the fair market value of the assets to be transferred to Controlled by Distributing will, in each instance, equal or exceed the sum of the liabilities assumed (within the meaning of § 357(d)) by Controlled.
- (k) The liabilities to be assumed (as determined under § 357(d)) by Controlled were incurred in the ordinary course of business and are associated with the assets being transferred.
- (l) No intercorporate debt will exist between Distributing and Controlled at the time of, or after, the distribution.
- (m) Immediately before the distribution, items of income, gain, loss, deduction, and credit will be taken into account as required by the applicable intercompany transaction regulations (See § 1.1502-13 and § 1.1502-14 as in effect before the publication of T.D. 8597, 1995-2 C.B. 147, and as currently in effect; § 1.1502-13 as published by T.D. 8597). Further, an excess loss account, if any, with respect to the Controlled stock and the Sub 1 stock will be included in income immediately before the distribution (See § 1.1502-19).

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- (n) Payments made in connection with all continuing transactions, if any, between Sub 1 and Sub 2, and the Distributing group and Controlled group generally, will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.
- (o) No two parties to the transactions are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).
- (p) The distribution is not part of a plan or series of related transactions (within the meaning of § 355(e)) pursuant to which one or more persons will acquire, directly or indirectly, stock representing a 50 percent or greater interest (as defined in § 355(d)(4)) in Distributing or Controlled.
- (q) Immediately after the distribution, no person will hold, directly or indirectly, disqualified stock (within the meaning of § 355(d)(3)) in Distributing or Controlled that constitutes a 50 percent or greater interest (within the meaning of § 355(d)(4)) in Distributing or Controlled.

Based solely on the information submitted and on the representations set forth above, we rule that:

- (1) The transfer by Distributing of all of the stock of Sub 1 and the interest in LLC 2 to Controlled in exchange for all of the outstanding stock of Controlled and the assumption by Controlled of certain liabilities, followed by the distribution of the Controlled stock to the shareholders of Distributing will be a reorganization within the meaning of § 368(a)(1)(D) of the Internal Revenue Code. Distributing and Controlled will each be "a party to a reorganization" within the meaning of § 368(b).
- (2) The transfer to Sub 1 by Controlled of the interest in LLC 2 will not prevent the transaction described in ruling (1) from qualifying as a reorganization under § 368(a)(1)(D).
- (3) The cancellation of debt owing by Distributing to Sub 1 in the amount of \$ 1 dollars shall qualify as a distribution of property subject to § 301(a) and § 1.1502-13 of the Income Tax Regulations.
- (4) No gain or loss will be recognized by Distributing on its transfer of assets to Controlled in exchange for Controlled stock and the assumption of liabilities (§§ 361(a) and 357(a)).

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- (5) No gain or loss will be recognized by Controlled on the receipt of the assets in exchange for its stock (§ 1032(a)).
- (6) The basis of the assets received by Controlled will be the same as the basis of the assets in the hands of Distributing immediately prior to transfer (§ 362(b)).
- (7) The holding period of the assets received by Controlled will include the respective periods during which such assets were held by Distributing (§ 1223(2)).
- (8) No gain or loss will be recognized by (and no amount will be included in the income of) the stockholders of Distributing on the receipt of the Controlled stock (§ 355(a)).
- (9) The basis of the stock of Distributing and Controlled in the hands of the Distributing shareholders immediately after the distribution of Controlled stock will be the same as the basis of the Distributing stock in their hands immediately before the distribution allocated between the Distributing stock and the Controlled stock in proportion to the fair market value of each in accordance with § 1.358-2(a)(2) (§ 358(b)).
- (10) The holding period of the Controlled stock received by shareholders of Distributing will include the holding period of the Distributing stock with respect to which it was distributed, provided that such stockholder held the Distributing stock as capital asset on the date of the distribution (§ 1223(1)).
- (11) No gain or loss will be recognized by Distributing on the distribution to its stockholders of all of its Controlled stock (§ 361(c)).
- (12) As provided in § 312(h) of the Code, proper allocation of earnings and profits between Controlled and Distributing will be made under § 1.312-10(a).

No opinion is expressed about the tax consequences of the transaction under other provisions of the Code and regulations or about the tax treatment of any conditions existing at the time of, or effects resulting from, the transaction that are not specifically covered by the above rulings.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

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A copy of this letter should be attached to the federal income tax returns of the taxpayers involved for the taxable year in which the transaction covered by this ruling letter is consummated.

In accordance with the power of attorney on file with this office, this letter is being sent to the taxpayer's representative with a copy to the taxpayer.

Sincerely,

Debra Carlisle

Debra Carlisle
Chief, Branch 5
Office of Associate Chief Counsel
(Corporate)

cc: